

CIA/OER/S-07531-75 FLOWING OIL STORAGE DISAPPEARING MAY 75
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CIA CLK/S - 07331-75

CIA Control No. 9624-75

16 May 1975

MEMORANDUM FOR: The Honorable Thomas O. Enders
Assistant Secretary for Economic
and Business Affairs
Department of State

SUBJECT : Floating Oil Storage
Disappearing

1. The major industrial countries currently have an extra cushion in the form of floating storage against any new oil embargo. This cushion, however, is rapidly being reduced. We estimate that it will disappear by fall -- exactly the time when, according to the recent SNIE, the threat of renewed war in the Middle East will be greatest. SNIE 30-1-75 indicates that, in the event of war, an embargo of the United States becomes highly likely. Floating storage at the 1 April level -- about 300 million barrels, according to our estimate -- is the equivalent of some 190 days of current US imports of Arab oil.

2. The attached articles from the International Oil Developments weekly give our estimates of floating storage and the reasons and implications of its drawdown. I have also attached a copy of the Memorandum for Holders of SNIE 30-1-75, Next Steps in the Middle East.

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MAURICE C. ERNST
Director
Economic Research

Attachment
As stated

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MEMORANDUM FOR HOLDERS
OF SNIE 30-1-75
NEXT STEPS IN THE MIDDLE EAST

DISCUSSION

1. SNIE 30-1-75 of 27 March 1975 addressed the near-term prospects for renewed warfare and for further negotiations in the Middle East in the immediate aftermath of the breakdown of US-mediated Egyptian-Israeli disengagement talks. The SNIE concluded that there was a substantial chance of war at any time and that the odds favored a renewal of hostilities by early summer if no progress had been made in negotiations. We had little optimism that significant progress could be made at a Geneva peace conference, if indeed the conference could be reconvened -- itself a doubtful prospect in view of the problem of Palestinian representation.

Recent Developments

2. Developments since publication of the SNIE have led us to revise our judgment on the imminence of another round of Arab-Israeli hostilities. We have reached no different conclusion, however, on the dim prospects for progress in negotiations and thus on the ultimate prospects for a renewal of warfare. Several developments since late March point to -- and in some cases

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dictate -- a conscious decision by the concerned parties to avoid hostilities at least for the next few months.

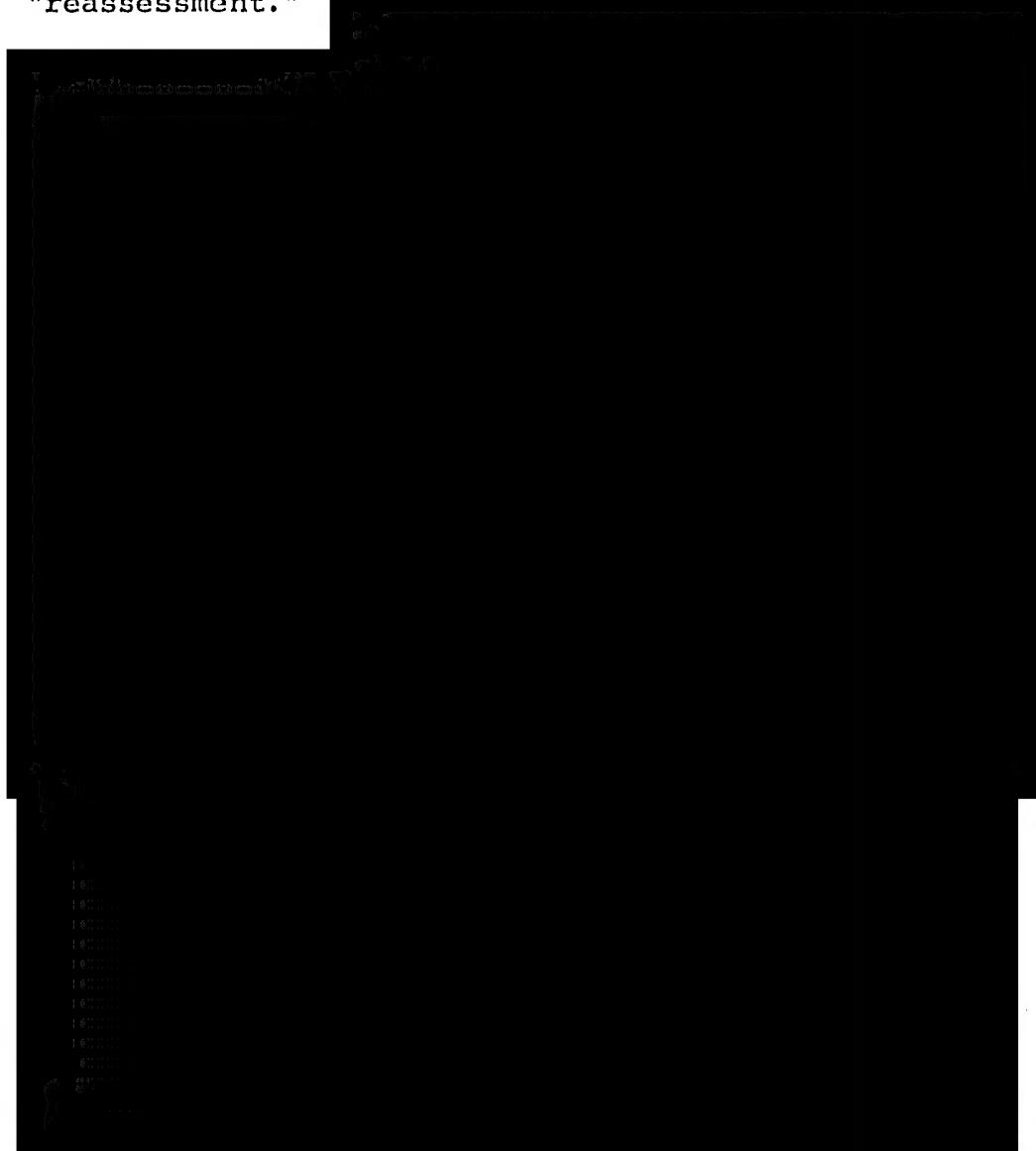
-- All parties are awaiting the outcome of the US policy "reassessment."

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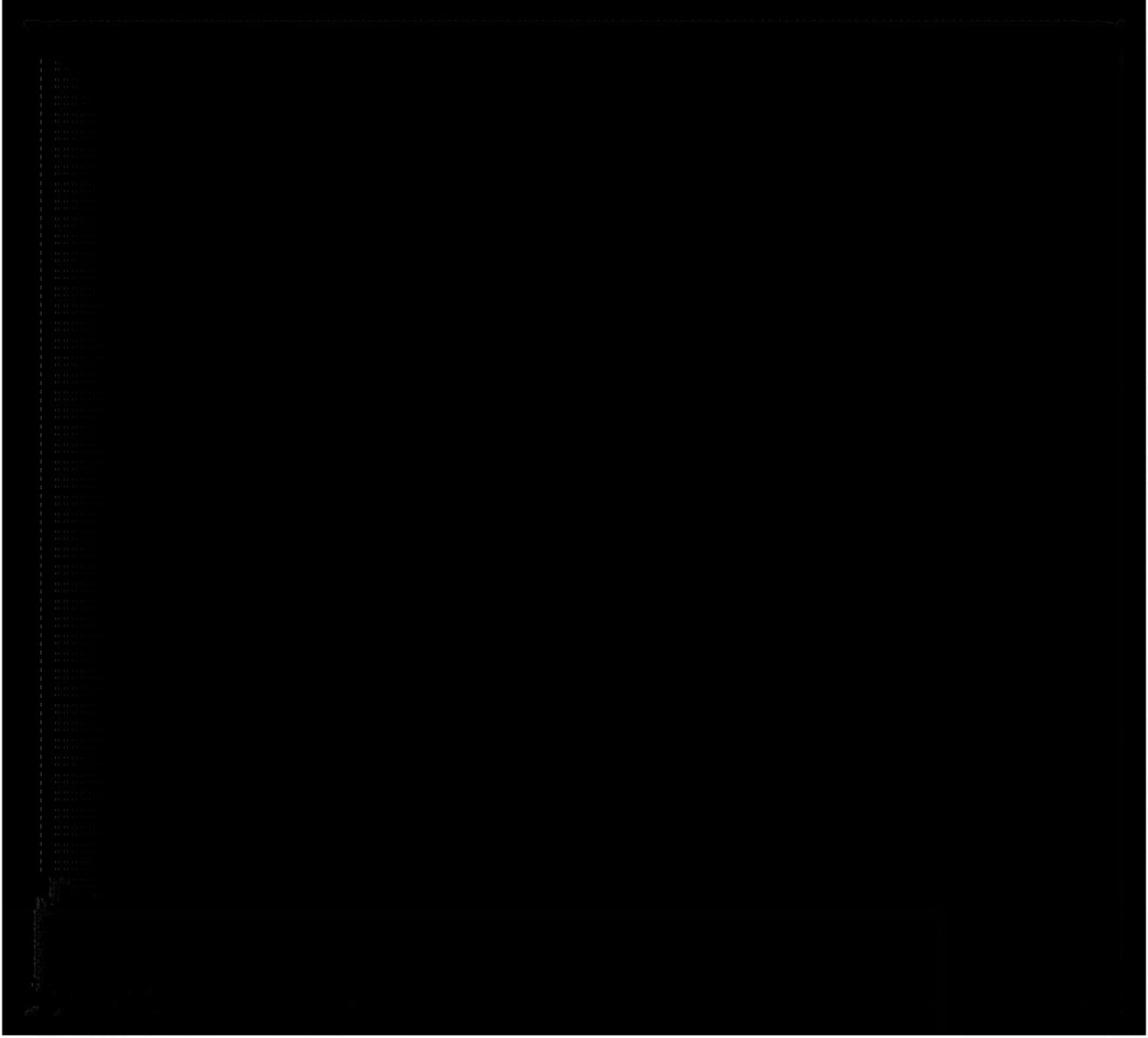
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The Soviet Attitude

23. Soviet behavior since issuance of the SNIE reinforces our conclusion that, while Moscow will move to exploit the opportunities inherent in the new situation, it is well aware of

of the risks and problems which will be encountered at the Geneva conference. The Soviets have met with the major Arab parties in the dispute and have even dispatched emissaries to Israel in an attempt to encourage Tel Aviv's attendance at Geneva. To promote diplomatic movement, the Soviets have been willing to risk Arab displeasure by displaying some evenhandedness. Notable in this regard are Foreign Minister Gromyko's statements during the visits by the Egyptian and Syrian foreign ministers in April that the USSR not only supports but is willing to guarantee Israel's existence. The Soviets hope their diplomatic efforts will demonstrate to Israel and the Arabs that Moscow -- as well as the US -- can play a constructive diplomatic role. At the same time, the Soviets have sought to allow for a possible resumption of Secretary Kissinger's negotiating effort and to minimize the risks to themselves by urging that it be undertaken under the auspices of a renewed Geneva conference.

24. One problem in preparing for Geneva that has turned out to be tougher for Moscow than was foreseen in the SNIE is that of Palestinian participation. The Soviets have been exploring several options. They have continued to encourage Jordanian attendance at the conference, hoping that, despite the decisions of the Rabat summit, Amman could play a role in

a compromise formula on the Palestinian issue. The Soviets may also be willing to put off the Palestinian representation issue until later in the conference, but they do not want to damage their influence with the PLO by forcing this on Arafat. The Soviets, however, may seek to strike a bargain with the PLO, such as trading formal Soviet recognition for PLO acquiescence in deferring the Palestinian issue.

25. The Soviets clearly need and want Cairo's cooperation in getting Geneva organized. The somewhat less strained atmosphere during Fahmi's last trip to Moscow suggests that the Soviets have made a little headway, but they have kept to a tough line on bilateral issues. For instance, they have not agreed to replace Egypt's war losses fully, nor to lessen its economic crunch by rescheduling Egypt's debt. The basic Soviet distrust of Sadat continues, and these problems will limit Moscow's willingness to employ its military forces to save his regime in the event of a new war.

26. We have seen no evidence of military movements, stepped-up intelligence, or other signs that the Soviets believe war is imminent. Moscow appears to expect that, at least over the next few months, preparations for a return to Geneva will reduce the possibility of a new war. The Soviets have suggested, for example, that the Syrians will extend the UNDOF mandate in order

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to facilitate the conference, and there are even some tenuous signs that Moscow thinks the Geneva process can be prolonged into next fall.

27. Beyond this point, the Soviet crystal ball probably is hazy. Moscow is probably skeptical that the US -- preoccupied with executive-legislative conflict and with an upcoming presidential campaign -- will bring enough pressure to get meaningful Israeli concessions. The Soviets will also want to consider what impact US withdrawal from Indochina will have on the Middle East. In the meantime, the Soviets will see the political imperative in doing everything they can to help the Arabs achieve their objective without a recourse to arms.

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INTERNATIONAL OIL DEVELOPMENT

Miscellaneous

THE DRAWDOWN IN FLOATING OIL STOCKS

If the drawdown of floating oil stocks continues at recent rates, importing countries will largely lose this margin of protection against embargo by August, when increased risk of hostilities in the Middle East is in prospect. President Sadat has extended the life of the UN Emergency Force in the Sinai only until 31 July and has warned that further extension depends on progress in Middle East negotiations. If no progress is made and the UN force departs, the threat of war and an associated Arab oil embargo will grow.

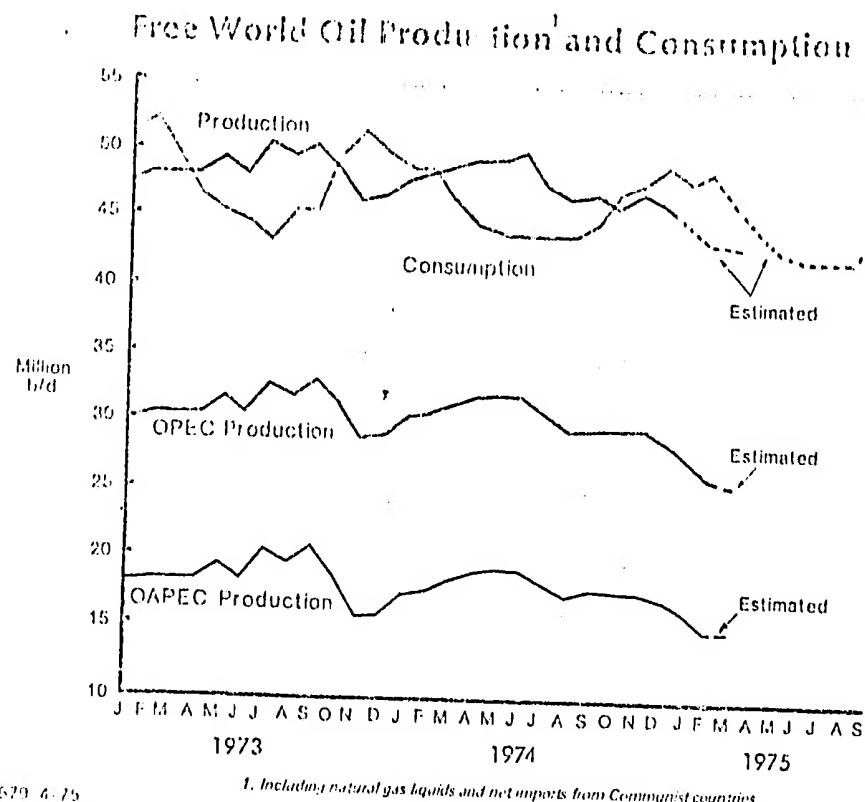
In the event of an embargo last winter, oil importing states would have been able to draw on excess oil supplies being stored at sea, as well as on the usual on-shore inventories. At the end of February, floating oil stocks - built up by reducing tanker speeds - reached an estimated 350 million barrels, an amount equal to 24 days of Arab output. The companies accumulated these excess supplies in the second half of 1974 mainly because they did not foresee the amount by which oil demand would fall as a result of high oil prices and the economic slump in the industrialized countries. In some instances, companies were willing - even eager - to let stocks build up because they anticipated further increases in OPEC oil prices.

The companies began drawing down the excess stocks late in the first quarter of 1975, when they apparently concluded that economic growth and oil demand would remain weak throughout the year. The OPEC states' stated intention to freeze basic oil prices through the third quarter also lessened the incentive to hold abnormally large inventories. Since maintenance of stocks is costly - nearly 10 cents a month in finance charges alone for each barrel stored - the companies started rapid reduction of stocks to normal working levels.

We believe that the supply of oil in floating storage was reduced in March by about 1.5 million b/d, or nearly 50 million barrels. If such a rate of withdrawal persists, as seems likely, floating stocks will be largely dissipated by August. In case of an Arab embargo at that time, oil importing nations* would have the cushion only of regular on-shore stocks, which range from a low of about 60 days of consumption in Japan to an average of about 90 days in Western Europe. (Secret No Foreign Dissem) n

* US oil stocks in mid-April were about 1 billion barrels. Main product and crude stocks totaled 858 million barrels according to the American Petroleum Institute, while stocks of other oil products totaled about 150 million barrels. About 600 million barrels (35 days of consumption) are estimated to be required for operation of the distribution system, leaving some 400 million barrels, or about 25 days of consumption, to cushion against import losses. At current levels, these stocks are equivalent to about 65 days of imports.

If supplies remain near the current level of 43 million b/d, the companies will have liquidated most of their excess seaborne inventories by August and will then need to push up output of OPEC oil by 3 million b/d. If economic recovery broadens toward the end of the year, the required increase in OPEC output would be even larger. The companies, alternatively, may elect to draw down inventories even faster than in March. In this event, OPEC output would fall a little further in the next weeks and months but would also rise sooner or more sharply when the excess stocks were liquidated.



In neither case do we expect the scale of company listings to pose serious problems for OPEC as long as the major OPEC nations, particularly Saudi Arabia, are willing to wait out the reduced levels of production and revenue for a few months. Certainly the Saudis have no financial reason for impatience. The rapid run-down of floating stocks now under way does, however, have implications for consuming nations in the event of a new oil embargo. At their estimated February levels of 350 million barrels, these extra floating stocks were equivalent to about 20 days of OAPEC output. At current rates of drawdown, this extra margin of protection will be dissipated by the end of the summer. (Secret No Foreign Dissem)

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INTERNATIONAL OIL DEVELOPMENTS

Current Overview

Some further cuts in OPEC output are likely in the next few weeks as the oil companies continue to draw down the huge stock of crude oil in floating storage. The long slide in OPEC output, however, is nearing an end. The next significant change is likely to be a sharp increase in the demand for OPEC oil late this summer, perhaps on the order of 3 million b/d.

Total new Free World oil supplies were about 43.1 million b/d in March - 40.3 million b/d crude oil production, 2.0 million b/d output of natural gas liquids, and 800,000 b/d net imports from the Communist countries. We estimate that Free World oil consumption was about 46 million b/d, putting stock drawdowns at about 3 million b/d. March stock drawdowns normally would have been only about half this.

Oil production in March was lower than normal because the companies apparently decided to reduce the extraordinarily large floating oil stocks built up during the second half of 1974. In that period the companies were unable to forecast accurately the amount by which oil demand would fall as a result of high oil prices and slumping economic activity. Companies also built up more stocks than usual in anticipation of further OPEC price increases.

With oil demand down and OPEC prices frozen through the third quarter, the companies now clearly want to reduce their stocks to normal working levels. (Finance charges alone cost the companies nearly 10 cents a month for each extra barrel held.) In February the companies were estimated to have had as much as 350 million barrels of excess crude oil at sea, as well as full crude stocks on shore.

Oil consumption will continue to decline over the next several weeks as it normally does. We expect that mid-summer consumption this year -- taking into account seasonal factors and the current economic slump -- will average 42-43 million b/d. Summer oil production would normally be expected to run about 45 million b/d (nearly 3 million b/d above consumption) as the companies replenish stocks in anticipation of winter. Production in summer 1975 will probably remain below normal until the companies have liquidated excess inventories.

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Note: Comments and queries regarding this publication are welcomed. They may be directed to [REDACTED] of the Office of Economic Research, [REDACTED]

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1 May 1975